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HEADLINE: Charles Gasparino and market panel Jack Ablin, John Rutledge and Pat Dorsey discuss backdating stock options

ANCHORS: LARRY KUDLOW

REPORTERS: CHARLES GASPARINO

BODY:

President GEORGE W. BUSH: My point, though, to corporate America is, you know, if--the people watch this, and they--they--they, you know, overcompensating or trying to backdate things, is--is bad for America. And there ought to be consequences when people don't tell the truth and are not transparent.

LARRY KUDLOW, host:

Boy, I think he nailed that completely. By the way, Bush does not want the government to regulate compensation. He wants the corporate boards to do their job, as John Rutledge noted, and have shareholders look at it. Now Bush also spoke about backdating.

Charlie Gasparino, I--OK, Charlie, I'm going to call...

CHARLES GASPARINO reporting:

I don't get any backdated options. That's all I know.

KUDLOW: I'm going to call it alleged fraud, Charlie, but I really want to call it fraud. I don't need an adjective here, and according to the news in the last few days, more examples of backdating are coming. So, Charlie, this could be an ac--epidemic.

GASPARINO: Well, listen, if this isn't at the very top of the SEC's enforcement agenda, it's really close to it. I mean, this is really in Cox's wheel house. I mean, he really likes this issue of executive compensation, and for two reasons. Number one, let's face it. His big issue so far has been disclosing executive compensation and this seems to run counter to that, but number two is Cox hates regulation, and he thinks if he can hammer people through enforcement action that he can set an example of a company violating the anti-fraud statutes of the Securities Act of '33 and '34, that's better than regulating, and like I said, I'll never say this is fra--fraud until I see the paperwork, until they convict somebody, or till they fire char--file charges, but it smells pretty bad.

KUDLOW: Yeah, I mean, listen, Jack Ablin, Power Integrations was the most recent one. That was broken on

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Friday, but Vitesse Semiconductor, UnitedHealth Group was probably one of the worst offenders, as was their CEO Mr. McGuire, but what's your--what's your take on this because there's two ways to do it, Jack.

TEXT:

Companies under fire

Option Backdating Watch

Power Integrations Vitesse Semiconductor UnitedHealth Group Comverse Technology Mercury Interactive Jabil Circuit Affiliated Computer Services Brooks Automation

Mr. JACK ABLIN (Harris Private Bank): Well...

KUDLOW: There's backdating and present dating.

Mr. ABLIN: Right.

KUDLOW: Because that's what people have missed. They can backdate it, but they can present date it also when they exercise these options.

Mr. ABLIN: Yeah, in fact, you know, just stepping back for a second, I--I have to say these option compensation programs, probably one of the most insidious transfers of wealth our nation's history has seen. You go back to the '90s, when companies didn't have to put option costs in their income statements, and then what they did was they, you know, stock buybacks and ran up their stock price and then took shares away from shareholders. I mean, we have a huge storied history in the--in these options. I think it's a pernicious problem that needs to be addressed.

KUDLOW: John Rutledge, do you have any disagreement in that? I want to say, when you read in the paper, let's say Power Integrations and so forth, there's a...

Mr. JOHN RUTLEDGE (Former Reagan Economic Advisor): Yep.

KUDLOW: ..do you sell the stock? What do you do? Do you get out of the stock right away or how do you play it?

Mr. RUTLEDGE: I would wait for the stock to fall on this news 20 percent, and then I'd probably buy some and just hold it on the bounce because I think this stuff isn't material to a company's performance, but it's fraud. People who commit fraud ought to go to jail.

KUDLOW: Do you hear that, Charlie? He didn't say alleged fraud. He didn't say alleged fraud. Sorry, John. We've got...

GASPARINO: Lar--lar--Larry, let me--let me--let me make one--let me just make--let me just make one point, Larry?

Mr. RUTLEDGE: We've got investors trying to make a decision about where to place their capital, here in America or in China. The big difference is the risk. The risk and the legal system. We've got to enforce these laws.

GASPARINO: Well, Larry, these are not slam-dunk cases though.

Mr. RUTLEDGE: And it's up to the courts to do it.

GASPARINO: You--you have to--let me just make one point. The SEC--people at the SEC tell me these are not slam--necessarily slam-dunk cases. Listen, you could set an option price wherever you want. The problem is if you disclose it, if you're disclosing that the option price is set at the market value, and then lo and behold and you start

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backdating it, that's when you can have fraud. But if it's not in the prospectus...

Mr. RUTLEDGE: I've never seen a board...

GASPARINO: ...if it's not disclosed that it's the market price, then you've got a problem.

Mr. RUTLEDGE: I have never seen a board create a strike price below the market price in my life.

GASPARINO: Well, it has to be in--it has to be in the documents.

Mr. RUTLEDGE: I have saved people tons of money through option programs and gotten full value for it.

KUDLOW: But wait a second. Let's bring in Mr. Morningstar, Pat Dorsey. Now, Pat, I want to go back to this point. You can backdate it several years ago, but they also have elbow room, these CEOs, with respect to present dating. They can say, 'I'm going to take it in three weeks. I'm putting out a lousy earnings statement now, my stocks going to drop 9 percent, and I'm going to wait to exercise the options for a month or two.'

Mr. PAT DORSEY (Morningstar Director of Research): Exactly.

KUDLOW: So you've got two potential pitfalls. Would you dump these stocks if you get wind of this?

Mr. DORSEY: What you just described may not violate the letter of the law, but it certainly violates the spirit of the law in my opinion.

Mr. RUTLEDGE: Sure does.

Mr. DORSEY: And what I would say, and I'm in Jack's camp, that, you know, the options bonanza of the '90s was giant transfer of wealth from shareholders to management team. And when you see this kind of behavior, whether it's legal or not, it's immoral, it represents poor stewardship of investors' capital, I'd sell the stock.

KUDLOW: Pat Dorsey, would you advise Charlie Gasparino to look out for ethical fraud as well? Charlie seems to be thinking by the letter of the law.

GASPARINO: I write about ethics all the time. What are you talking about?

KUDLOW: You're it. You got it. He's just too tight, Charlie. These guys are guilty in this. They're guilty. And it's...

Mr. ABLIN: Look--and look what...

KUDLOW: ...either legally or ethically.

Mr. DORSEY: It just depends on what they're guilty of.

GASPARINO: Hey, they may be bad guys, they may have done something unethical. They're not guilty till they're guilty.

Mr. ALBIN: Look...

Mr. RUTLEDGE: This is front-running.

Mr. ALBIN: And then look what's going on in these buyback announcements.

KUDLOW: All right. We'll go to buybacks another time.

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Mr. ALBIN: OK.

KUDLOW: Up next, our market guests are going to stick around. They're going to give us a quick synopsis on what to watch for tomorrow's trading.

And then "On The Money" tonight at 7 PM, the first in a series of exclusive reports from China. Tonight how US companies are profiting by turning a once quaint town you've never heard of into a global economic force of five million people. That's "On The Money" tonight at 7. Meanwhile, KUDLOW & COMPANY coming right back after this break.

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